ANALYSIS OF FINANCIAL STATEMENTS: TRADING, PROFIT&LOSS ACCOUNT AND BALANCE SHEET

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ABSTRACT

Final Accounts is the last ladder of double entry system. We know that transactions are first recorded in journal (subsidiary books), then these are posted to their respective ledger Accounts. The Trial Balance is prepared to check the arithmetical accuracy in the books of accounts by taking the ledger account balances. After being satisfied that the books of accounts are arithmetically correct, the businessman gets interested in knowing the performance during the accounting period. For this purpose he prepares the condensed from of accounts known as Financial statements. Preparation of financial statements is the last phase of accounting process; these are also known as Final accounts. Financial statements generally refer to two basic statement, Trading and profit and loss accounts 2nd is position statement i.e Balance sheet.

KEYWORD: Trading and profit and loss accounts, Balance sheet, Table &figure.

1-INTRODUCTION

To start with we can say that, accounting is concerned with the processes of recording, sorting, and summarizing data resulting from business operations and events. . Accounting is an art: Accounting classifies as an art, as it helps in attaining our aim of ascertaining the financial results. Analysis & interpretation of financial data are the art of accounting, requiring special know ledge, experience and judgment.

The businessman also wants to know the financial position of his business on a particular date. This date is normally the last date of the financial year for which the accounts have been prepared. The statements, prepared to know the result of the business and the financial position of the business, are called financial statements. The statement prepared for ascertain gross profit/loss is called Trading Account. The statement prepared to ascertain the net profit is called Profit and Loss Account. Trading and Profit and Loss Account taken together is called the Income Statement. Statement prepared to know the financial position of the business is called the Balance Sheet or Position Statement.

1.1-IMPORTANCE OF THE STUDY

Financial accounting, which some call "the language of business," is important to companies of any size. For small-business owners, the importance of financial accounting sometimes is overlooked. By understanding how useful financial accounting can be to the success of a small business and can focus on the qualities that can take your business the furthest.

The businessman wants to ascertain the profit earned or loss suffered during the year and also the financial position of his business at the end of the year A major importance of financial accounting is for the recording of transactions.. This function of accounting is also known as bookkeeping. Small or Big-business owners use financial accounting to record business activity in the company's, journal, ledger and final accounts. This use of accounting is important for small or Big-business owners because it provides a methodological approach to describing the activities of business.

1.2-OBJECTIVES OF THE STUDY:-

- To the procedure of Preparing trading and profit and loss account and balance sheet of a business
- To ascertain the true financial position of the business at a particular point of time
- To study about Gross Profit and Gross Loss
- To study ascertain the Net Profit or Net Loss
- To ascertain the various assets &liabilities of the business.
- To study the comparison of closing stock with those of the previous years

1.3- METHODOLOGY OF THE STUDY

Research design

For the study purpose both primary and secondary data are used. For collection of primary data for this research work accounting techniques has been used. Accounting techniques is found suitable for this study because the study is a problem with analysis topic.

The study is based on both primary and secondary data**.**

Primary data:- The primary data is collected from the organization for the purpose of the study along with the secondary information to identify the business events and analyze these transactions, and record them as journal entries, ledger, trial balance, final account.

Secondary data:-The secondary data will be collected from the books, records available printed manuscripts, official and articles, journals, files and different booklet of organization.

2-TRADING ACCOUNT

Trading account is prepared for calculating the gross profit or gross loss arising or incurred as a result of the trading activities of a business. In other worlds, it is prepared to show the result of manufacturing, buying and selling of goods. If the amount of sales exceeds the amount of purchases and the expenses directly connected with such purchases, the difference is termed as gross profit. On the contrary, if the purchases and direct expenses exceed the sales, the difference is called gross loss. A Trading Account records the amount of purchases of goods and also the expenses which are incurred in bringing that commodity to a saleable state. IN other words, all expenses which relate to either purchase of raw material for manufacturing of goods are recorded in the Trading Account. All such expenses are called ‘Direct Expenses’. According to J.R. Batliboi, “The Trading Account shows the results of buying and selling of goods. In preparing this account, the general establishment charges are ignored and only the transaction in goods is included.”

Sometimes, a Trading Account is also called ‘Good A/c’ because all the transaction relating to goods are recorded in it. Such as (i) Opening Stock, (ii) Purchases, (iii) Purchases Returns, (iv) Sales, (v) Sales Returns, (vi) Closing Stock, (vii) Expenses incurred on manufacturing of goods, and (viii) Expenses incurred on purchasing and bringing the goods to the trading place. All such expenses are summarised and recorded in the Trading Account at the end of the year.

2.1-Preparation of Trading Account

Trading Account is a Nominal Account and all expenses which relate to either purchase or manufacturing of goods are written on the Dr. side of the Trading Account.

Item written on the Dr. Side of the Trading Account:

Opening Stock: The stock of goods remaining unsold at the end of the previous year is termed as the opening stock of the current year. In other words, the closing stock of the last year becomes the opening stock of the current year. Opening Stock will include the following:

I. Opening Stock of Raw Material.

II. Opening Stock of Semi-finished goods, and

III. Opening Stock of Finished goods.

Purchases and Purchases Returns: Goods which have been bought for resale are termed as Purchases and goods which are returned to suppliers are termed as purchase returns or returns outwards. Purchase Account will be given on the debit side of the trial balance and Purchase Return Account on the credit side of the trial balance. Purchase returns will be shown as a deduction from Purchases on the debit side of the trading account. Purchases include cash as well as credit purchases.

Direct Expenses: All expenses incurred in purchasing the goods, bringing them to the godown and manufactures of goods are called direct expenses. Direct expenses include the following:

Wages: Wages are paid to workers who are directly engaged in the loading, unloading and production of goods and as such are debited to the trading account. It should be noted that:

(i) If the item 'Wages and Salaries' is given in the question it will be shown on the trading account. On the contrary, if 'Salaries and Wages' is given it will be shown on the profit & loss account.

(ii) If wages are paid for bringing a new machine or for its installation it will be added to the cost of the machine and hence will not be shown in the trading account.

II **Carriage or Carriage Inwards or Freight:** These expenses should be debited to trading account because these are generally paid for bringing the goods to the factory or place of business. However, if any carriage or freight is paid on bringing an asset, the amount should be added to the asset account and must not be debited to trading account.

III **Manufacturing Expenses:** All expenses incurred in the manufacture of goods are shown on the debit side of the trading account such as Coal, Gas, Fuel, Water, Power, Factory Rent, Factory Lighting etc.

IV.**Dock Charges:** These are the charges levied on ships and their cargo while entering or leaving docks. If dock charges are paid on import of goods they are shown on the debit side of trading account. In the absence of specific instructions, these are debited to trading account.

V**Import Duty or Custom Duty:** Custom Duty is paid on import as well as on export of goods. Custom duty when paid on the purchase of goods is charged to trading account. In the absence of specific instructions, these are debited to trading account.

VI **Octroi:** This is levied by the Municipal Committee when the goods enter the city and hence debited to trading account.

VII.**Royalty:** This is the amount paid to the owner of a mine or patent for using his right or patent. Royalty is usually charged to trading account because it increases the cost of production. However, if it is specifically stated in the question that the Royalty is based on sales, it will be charged to Profit and Loss account.

2.2-Items written on the Cr. Side of the Trading Account:

Sales and Sales Returns: Both Cash and Credit sales will be included in sales. The sales account will be a credit balance whereas, the sales return account or returns inwards account will be a debit balance. Sales return will be deducted out of Sales on the credit side of the trading account.

Closing Stock: The goods remaining unsold at the end of the year is known as Closing Stock. It is valued at cost price or market price whichever is less . It includes the closing stock of raw material, Closing Stock of semi-finished goods and Closing Stock of finished goods.

Normally, the Closing Stock is given outside the Trail Balance. This is so because its valuation is made after the accounts have been closed. It is incorporated in the books by means of the following entry:

Closing Stock A/c Dr.

To Trading A/c

(Closing Stock transferred to Trading A/c)

When the above entry is passed, the Closing Stock Account is opened. On the one hand, it will be posted to the credit side of the trading account and on the other hand, will be shown on the Assets side of the Balance Sheet, in order to complete the double entry. Sometimes, the Closing Stock is given inside the Trail Balance. This mean that the entry to incorporate the closing stock in the books has already been passed. It would imply that the Closing Stock must have been deducted out of Purchases Account. Hence, in such a case, Closing Stock will not be shown in the Trading Account but will appear on the Assets side of the Balance Sheet only.

Closing Entries Relating to Trading Account

The preparation of the Trading Account requires that the balances of all such accounts which are due to appear in the Trading Account are transferred to it. The entries required for such transfer are termed as Closing entries. These will be as follows:

1. Purchases Return Account is closed by transferring its balance to Purchase Account. Following entry is recorded for this purpose.

Purchases Return A/c Dr.

To Purchases A/c

(Transfer of Purchases Return Account to Purchases (Account)

2. Similarly, the Sales Return Account is closed by transferring its balance to the Sales Account as:

Sales A/ct Dr.

To Sales Return A/c

(Transfer of Sales Return Account to Sales Account)

3. Closing entry for those accounts which are to be transferred to the Dr. side of the Trading Account:

Trading A/c Dr.

To Opening Stock A/ct

To Purchases A/c

To Wages A/c

To Direct Expenses A/c

To Carriage A/c

To Gas, Fuel & Power A/c

To Freight, Octroi & Cartage A/c

To Manufacturing exp. A/c

To Factory Rent & Lighting A/c

To Custom Duty A/c

To Royalty A/c

(Transfer of above accounts to the Dr. side of the Trading A/c)

4. Closing entry for those accounts which are to be transferred to the Cr. Side of the Trading Account:

Sales A/c Dr.

Closing Stock A/c Dr.

To Trading A/c

(Transfer of above accounts to the Cr. Side of the Trading A/c)

5. Another Closing entry is needed to close the trading account itself. If the credit side of the Trading Account exceeds the debit, the difference will be Gross Profit. The Gross Profit will be transferred to the credit of a newly opened account called profit and loss account:

Trading A/c Dr.

To Profit & Loss A/c

(Transfer of Gross Profit to the Credit side of P & L A/c)

6. If the debt side of the Trading Account exceeds the credit, the difference will be Gross Loss. It will be transferred to the debit of P & L a/c by means of the following entry:

Profit and Loss A/c Dr.

To Trading A/c

(Transfer of Gross Loss to the Debit side of P & L A/c)

2.3-ANALYSIS OF TRADING ACCOUNT

Prepare a Trading Account for the year ended 31st December 2010 from the following balances: **Table-1**

	Rs.		Rs.
Opening Stock	4,00,000	Purchases Return	1,20,000
Purchases	20,00,000	Sales Return	2,00,000
Sales	50,00,000	Carriage on Purchase	80,000
Freight and Octroi	65,000	Carriage on sales	1,00,000
Wages	3,00,000	Factory Rent	1,20,000
Factory Lighting	1,08,000	Office Rent	75,000
Coal, Gas and Water	22,000	Import Duty	3,20,000

Closing Stock is valued at Rs. 6,00,000.

2.3.1-ANALYSIS OF TABLE-1

Table-1

TRADING A/C

(for the year ended……………..)

Dr. Cr.

Particular		**Amount**	**Particulars**		**Amount**
		Rs.			Rs.
To Opening Stock		4,00,000	By Sales	50,00,000	
To Purchases	20,00,000		*Less:* Sales Returns	2,00,000	48,00,000
*Less:*Purchases Return			By Closing Stock		6,00,000
	1,20,000	18,80,000			
To Freight and Octroi		65,000			

To Wages	3,00,000		
To Factory Lighting	1,08,000		
To Coal, Gas and Water	22,000		
To Carriage on Purchase	80,000		
To Factory Rent	1,20,000		
To Import Duty	3,20,000		
To Gross Profit transferred to Profit & Loss A/c	21,05,000		
	54,00,000		54,00,000

Notes: (1) In the heading of the Trading Account the words 'For the year ended……' are Used. Because it discloses the position of the business for the full accounting year and not at a Particular point of time.

(2) No separate column for date is prepared in the Final Accounts because the date will be already mentioned in the heading itself.

(3) No column for L.F. is prepared in Final Accounts because these are prepared from trial balance and not from ledge accounts directly.

3-PROFIT AND LOSS ACCOUNT

Trading account only discloses the gross profit earned as a result of buying and selling of goods. However, a businessman has to incur a number of expenses which are not taken to trading account. Hence, a businessman is more interested in knowing the net profit earned or net loss incurred during the year. As such, a Profit & Loss Account is prepared which contains all the items of losses and gains pertaining to the accounting period. According to Prof. Carter, "A Profit & Loss Account is an account into which all gains and losses are collected, in order to ascertain the excess gains over the losses or*vice-versa*".

3.1-Items written on the Dr. side of Profit & Loss Account

Gross Loss: If trading account discloses Gross Loss, it is shown on the debit side first of all.

Office and Administrative Expenses: Such as salary of office employees, office rent, lighting, postage, printing, legal charges, audit fee etc.

Selling and Distribution Expenses: Such as advertisement charges, commission, carriage outwards, bad-debts, packing charges etc.

Miscellaneous Expenses: Such as interest on loan, interest on capital, repair charges, depreciation, charity etc.

3.2-Items written on the Cr. side of Profit & Loss Account

Gross Profit: the starting point of the Cr. side of Profit and Loss Account is the gross profit brought down from the Trading Account.

Other Incomes and Gains: All items of incomes and gains are shown on the credit side the Profit & Loss Account, such as income from investments, rent received, discount received, commission earned, interest received, dividend received etc.

If the credit side of the profit and loss account exceeds that of debit side, the difference is termed as net profit. On the other hand, the excess of the debit side over the credit side is termed as net loss. Net profit is added to the capital whereas net loss is deducted from the capital.

Closing Entries relating to Profit and Loss Account

The preparation of profit and loss account requires that the balances of all concerned items are transferred to it by passing the following closing entries:

1. Accounts of various items of expenses and losses are transferred to the debit side of Profit and Loss Account by means of the following entry:

Profit and Loss A/c Dr.

To Salaries A/c

To Rent, Rates and Taxes A/c

To Printing and Stationer A/c

To Postage and Telegrams A/c

To General Expenses etc.

(Transfer of nominal accounts showing Dr. balances to the Debit of P & L A/c)

2. Balances of all the accounts of incomes and gains will be transferred to the credit side of Profit and Loss Account by means of the following entry:

Interest Received A/c Dr.

Commission Received A/c Dr.

Rent Received A/c Dr.

To Profit and Loss A/c

(Transfer of nominal accounts showing Cr. balances to the Credit of P & L A/c)

3. For the transfer of credit balance of Profit & Loss A/c, known as net profit:

Profit and Loss A/c Dr.

To Capital A/c

(Transfer of net profit to Capital A/c)

4. For the transfer of debit balance of Profit & Loss A/c, known as net loss: Capital A/c Dr.

To Profit and Loss A/c

(Transfer of net loss to Capital A/c)

3.3-ANALYSIS OF PROFIT AND LOSS ACCONT

From the following particulars, prepare a Profit & Loss Account for the year ending 31st December, 2010. **Table-2**

	Rs.		Rs.
Gross Profit	21,05,000	Discount allowed	30,000
Trade Expenses	20,000	Lighting	7,800
Carriage on Sales	1,00,000	Commission Received	8,400
Office Salaries	1,58,000	Bad-debts	12,000
Postage and Telegram	7,200	Discount (Cr.)	6,000
Office Rent	75,00	Interest on Loan	22,000
Legal Charges	4,000	Stable Expenses	14,000
Audit Fee	16,000	Export Duty	23,000
Donation	11,000	Miscellaneous Receipts	5,000
Sundry Expenses	3,600	Unproductive Expenses	41,000
Selling Expenses	53,200	Travelling Expenses	25,000

3.3.1-ANALYSIS OF TABLE-2

PROFIT AND LOSS ACCOUNT

for the year ending on 31st December, 2010

Dr. Cr.

Particulars	**Amount**	**Particulars**	**Amount**
	Rs.		Rs.
To Trade Expenses	20,000	By Gross Profit	21,05,000
To Carriage on Sales	1,00,000	By Commission Received	8,400
To Office Salaries	1,58,000	By Discount	6,000
To Postage & Telegram	7,200	By Miscellaneous Receipts	5,000
To Office Rent	75,000		
To Legal Charges	4,000		
To Audit Fee	16,000		
To Donation	11,000		
To Sundry Expenses	3,600		
To Selling Expenses	53,200		
To Discount Allowed	30,000		
To Lighting	7,800		
To Bad-Debts	12,000		
To Interest on Loan	22,000		
To Stable Expenses	14,000		
To Export Duty	23,000		
To Unproductive Expenses	41,000		
To Travelling Expenses	25,000		
To Net Profit transferred to Capital Account	15,01,600		
	21,24,400		**21,24,400**

Notes: **(1)** Those expenses which are not related to the business are not written in the Profit and Loss Account such as (i) Domestic and household expenses of the proprietor, (ii) Income-Tax, and (iii) Life Insurance Premium etc. These expenses are known as Drawings and deducted from Capital at the liabilities side of the Balance Sheet.

(2) Only those items of expenses and incomes are shown in the Profit & Loss Account which have not been shown in the Trading Account.

***** Income received by providing training to someone is called "Apprentice Premium".

4-BALANCE SHEET

After ascertaining the net profit or loss of the business enterprise, the businessman would also like to know the exact financial position of his business. For this purpose a statement is prepared which contains all the Assets and Liabilities of the business enterprise. The statement so prepared is called a Balance Sheet because it is a sheet of balances of ledger accounts which are still open after the transfer of all nominal accounts to the Trading and Profit & Loss Account. Balances of all the personal and real accounts are grouped as assets and liabilities. Liabilities are shown on the left hand side o the Balance Sheet and assets on the right hand side.

Definitions: A Balance Sheet has been defined as follows:

In the words of Karlson, "A business form showing what is owed and what the proprietor is worth, is called a Balance Sheet."

According to A. Palmer, "The Balance Sheet is a statement at a particular date showing on one side the trader's property and possessions and on the other hand the liabilities."

According to J.R. Batliboi, "A Balance Sheet is a statement prepared with a view to measure the exact financial position of a business on a certain fixed date."

Following points should be noted for preparing Final Accounts:

1. If a trial balance is not given in the question, it is better to prepare a Trial Balance first of all. If there is a difference in the Trial Balance, the difference is placed to a 'Suspense A/c' and shown in the Balance Sheet.

2. It should be remembered that all items which appear in the Trial Balance should be shown only once whereas items which appear outside the Trial Balance, known as adjustments, have to be shown at two places.

3. The items which appear on the debit side of the Trial Balance should be shown either on the debit side of the Trading or Profit and Loss A/c or on the Assets side of the Balance Sheet.

4. The items which appear on the credit side of the Trial Balance should be shown either of

the credit side of the Trading or Profit & Loss A/c or on the Liabilities side of the Balance

Sheet.

5- All accounts relating to Goods such as Purchases, Sales, Purchase Returns and Sales Returns are written in the Trading Account. In addition to these, the Trading Account will also be debited with all expenses which are directly related to either purchase or manufacturing of goods. All the remaining expenses or the balances of the Nominal Accounts are shown in the Profit & Loss Account.

6. The balances of Personal and Real Accounts are always shown in the Balance Sheet.

7. If the expenses in respect of 'Rent' and 'Lighting' are clearly stated as having been incurred in respect of factory, these will be shown in the Trading Account, otherwise these will be shown in Profit & Loss Account. For example, if 'Factory Rent' is given in the question, it will be shown in Trading Account. Instead, if 'Rent' is given, it will be shown in Profit & Loss Account.

8. If a trial balance is not given in the question, and it is not clearly stated whether a particular

item is expense or income, it will be treated as expense such as Discount, commission,

Brokerage or Rent etc.

9.The total of both sides of the Balance Sheet will always be equal.

4.1-ANALYSIS OF BALANCE SHEET

From the following balances of Siya Ram, Prepare a Balance Sheet as on 31st December, 2010. **Table-3**

Particulars	**Amount (Dr.)**	**Amount (Cr.)**
Plant and machinery	8,00,000	
Land and Building	6,00,000	
Furniture	1,50,000	
Cash in Hand	20,000	
Bank Overdraft		1,80,000
Debtors and Creditors	3,20,000	2,40,000
Bills Receivable and Bill Payable	1,00,000	60,000
Closing Stock	4,00,000	
Investments (Short-term)	80,000	
Capital		15,00,000
Drawings	1,30,000	
Net Profit		6,20,000
	26,00,0000	**26,00,0000**

4.1.1-ANALYSIS OF TABLE-3

BALANCE SHEET

as on 31st December, 2010

Liabilities		Amount	Assets	Amount
		Rs.		Rs.
Bank overdraft		1,80,000	Cash in Hand	20,000
B/P		60,000	B/R	1,00,000
Creditors		2,40,000	Investments (Short-term)	80,000
Capital			Debtors	3,20,000
Add: Net Profit	15,00,000		Closing Stock	4,00,000
	6,20,000		Furniture	1,50,000
	21,20,000		Plant & Machinery	8,00,000
*Less:*Drawings	1,30,000	19,90,000	Land & Building	6,00,000
		24,70,000		**24,70,000**

Notes: (1) The words 'As at' or 'As on' are used in the heading of the Balance Sheet. Because it is true only for the date on which it is prepared.

(2) The total of both the sides of the Balance Sheet is always equal.

(3) Prepaid expenses are treated as current assets. Though Cash cannot be realised from prepaid expenses, the service will be available against these without further payment. .

5-Conclusion:-

In the study of accounting by explaining the process used to record, classify, and summarize financial information. The trial balance and the principal of financial statements the balance sheet, trading, profit and loss account. The statement prepared for ascertain gross profit/loss is called Trading Account. The table -1 shows gross profit Rs 21,05,000 The statement prepared to ascertain the net profit is called Profit and Loss Account.The table shows net profit Rs15,01,600. Trading and Profit and Loss Account taken together is called the Income Statement. Statement prepared to know the financial position of the business is called the Balance Sheet or Position Statement. Balance sheet is to know the liabilities and assets position. Perhaps the most important aspect of accounting that learnt is the knowledge for all organizations and individuals their financial position.

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